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DEC 1
CHARLES ELMORE

No. 492-3

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

GENERAL GAS AND ELECTRIC CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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ARGUMENT:

Point I. The merger of two Pennsylvania Corporations under the Pennsylvania General Corporation Act of 1874, as amended, is such a merger as entitles the successor corporation upon the redemption and retirement of the bonds of the predecessor corporation to take as a deduction in computing its taxable income under the Revenue Act of 1926 the unamortized debt discount and expense which had been incurred at the time of the issuance of the bonds 10

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938. No. .

General Gas and Electric Corporation,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of the General Gas and Electric Corporation respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review the judgment of that Court entered in this case on July 18, 1938, rehearing denied September 1, 1938, and therefore shows as follows:

I.

SUMMARY STATEMENT OF MATTER INVOLVED.

Petitioner, General Gas and Electric Corporation, a corporation organized and existing under the laws of the State of Delaware, is and was at all times material to this proceeding, engaged in the business of holding securities thereby controlling public utility subsidiaries serving in various States (R. 96).

By an agreement entered into by and between the General Gas and Electric Corporation and its subsidiaries, the entire Federal Income Tax liability of each subsidiary corporation is to be assessed against and paid by the General Gas and Electric Corporation (R. 96).

In March 1926 the Northern Pennsylvania Power Company (a Pennsylvania Corporation), an affiliated subsidiary of the General Gas and Electric Corporation, acquired all of the assets, property and franchises and assumed all of the liabilities of the North Penn Power Company (a Pennsylvania Corporation) pursuant to and by virtue of the provisions of Section 23 of the General Corporation Act of 1874, as amended (appendix *infra*), of the laws of the Commonwealth of Pennsylvania (R. 96, 97).

Included among the liabilities of the North Penn Power Company, which has been assumed by the Northern Pennsylvania Power Company, were bonds in the principal sum of $552,700 (R. 97).

During the years 1926 and 1927 the Northern Pennsylvania Power Company retired all of the aforesaid outstanding bonds of the North Penn Power Company. At the time of retirement in 1926 there remained as unamortized debt discount and expense incurred upon the issuance and sale of these bonds the sum of $47,058.08 and with respect to those retired in 1927 the unamortized debt discount and expense amounted to $53,441.71 (R. 98).

In 1926 the Northern Pennsylvania Power Company also acquired, pursuant to the provisions of Section 23 of the General Corporation Act of 1874, as amended, (appendix *infra*) of the laws of the Commonwealth of Pennsylvania, all of the assets and assumed all of the liabilities of the Susquehanna County Light and Power Company (a Pennsylvania Corporation) (R. 99).

Included among the liabilities of the Susquehanna County Light and Power Company were bonds in the principal amount of $600,000. In 1926 the Northern Pennsylvania Power Company redeemed and retired the entire issue of the aforesaid bonds. At the date of redemption there remained $19,922.11 unamortized debt discount and expense which had been incurred upon the issuance and sale of the bonds by the Susquehanna County Power and Light Company (R. 100).

For the taxable years 1926 and 1927 General Gas and Electric Corporation filed consolidated income tax returns for itself and its subsidiaries, including

the Northern Pennsylvania Power Company. In its returns for those years the General Gas and Electric Corporation in computing the taxable income deducted the unamortized debt discount and expense sustained by the Northern Pennsylvania Power Company at the time of the retirement by it of the bonds of the North Penn Power Company and the Susquehanna County Light and Power Company.

The Commissioner of Internal Revenue refused to allow the deductions in the years 1926 and 1927. Petitioner filed separate petitions to the United States Board of Tax Appeals, one for the year 1926 and the other for the year 1927, and since they presented a common question of law the same were consolidated for hearing before the Board which held in a memorandum opinion that the unamortized debt discount and expense were not proper deductions. Separate petitions for review were presented to the Circuit Court of Appeals for the Second Circuit, which petitions were consolidated and the orders of the Board of Tax Appeals affirmed in the judgment rendered by that Court.

(There were two petitions to the United States Board of Tax Appeals, one bearing Docket No. 52639 and the other bearing Docket No. 59469. The cases were consolidated before the Circuit Court and since all of the facts essential to the determination of the proceedings appear in case bearing Docket No. 52639, all references to the Record refer to the Record in that case.)

II.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRITS.

The Circuit Court of Appeals for the Second Circuit in holding that the petitioner in computing its consolidated income tax was not entitled to deduct the unamortized debt discount and expense outstanding on the books of the Northern Pennsylvania Power Company at the time that it redeemed and retired certain bonds is in direct conflict with the holding of the Circuit Court of Appeals for the Third Circuit in the case of *Metropolitan Edison Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd 1938), 98 Fed. (2d) 807, and the holding of the same Court in the case of *Pennsylvania Water and Power Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 812. In both of the cases decided by the Circuit Court of Appeals for the Third Circuit, the petitioners therein had redeemed and retired bonds which had previously been issued by corporations which had been absorbed by the petitioners therein in accordance with the provisions of Section 23 of the General Corporation Act of 1874 as amended (appendix *infra*), of the laws of the Commonwealth of Pennsylvania. In their income tax returns for the years in which the bonds had been redeemed and retired the petitioners therein deducted the unamortized debt discount and expense connected with the issuance of the Bonds. In those cases the

Commissioner of Internal Revenue, as in the instant case, disallowed the deductions so claimed and was sustained by the United States Board of Tax Appeals. The orders of the United States Board of Tax Appeals were, however, reversed by the Circuit Court of Appeals for the Third Circuit on petitions for review.

In deciding the ***Metropolitan Edison case*** and the ***Pennsylvania Water and Power Company case*** the Circuit Court of Appeals for the Third Circuit held that the transactions by which the petitioners therein took over the subsidiary corporation constituted true mergers under the laws of the Comomnwealth of Pennsylvania and were not sales, so that the petitioners therein were entitled to the deductions claimed.

The Circuit Court of Appeals for the Second Circuit in the instant case, however, in passing upon the same question, held that the transactions by which the Northern Pennsylvania Power Company absorbed both the North Penn Power Company and the Susquehanna County Light and Power Company were not true mergers but sales and, therefore, petitioner was not entitled to take as a deduction on the consolidated income tax returns for the years 1926 and 1927, the unamortized debt discount and expense remaining when the bonds were redeemed and retired in those years.

The decision of the Circuit Court of Appeals for the Second Circuit in the instant case is directly contrary to the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Metropolitan Edison Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 807, and *Pennsylvania Water and Power*

Company, Petitioner v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 812, although each Court had before it the identical question for disposition.

If the decision of the Circuit Court of Appeals for the Second Circuit is allowed to stand, there is a direct conflict with the two decisions of the Circuit Court of Appeals for the Third Circuit. The question involved in all of these cases is one of general importance affecting the income tax liability of a number of corporations. The principle involved will find frequent application in connection with the taxation of corporations which, having merged with others in accordance with certain statutory provisions of the Commonwealth of Pennsylvania, redeem and retire bonds issued by the absorbed companies on which there is still outstanding unamortized debt discount and expense incurred at the time of the issuance of the bonds.

WHEREFORE it is respectfully submitted that this petition for writs of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit should be granted.

And your petitioner will ever pray, etc.

GENERAL GAS AND ELECTRIC CORPORATION,
By
MAURICE BOWER SAUL,
Counsel for Petitioner.

WILLIAM H. S. WELLS
BRADFORD S. MAGILL
FRANCIS J. SWEENEY
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DECEMBER 1, 1938.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The opinion of the Circuit Court of Appeals is reported in 98 Fed. (2d) 561. It will be found on page 184 of the Record. The findings of fact and the opinion of the Board of Tax Appeals are contained in a memorandum opinion entered June 3, 1937, and will be found on pages 166-176 of the Record.

JURISDICTION.

1. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938; Title 28 U. S. C. A., Section 347.

2. The judgment of the Circuit Court of Appeals was entered on July 18, 1938 (R. 184). Petition for rehearing was filed August 3, 1938, within the time provided by the Rules of the Circuit Court of Appeals (R. 188), and the petition for a rehearing was denied September 1, 1938 (R. 192).

3. The nature of the case, the rulings of the Board of Tax Appeals, and the Circuit Court of Appeals for the Second Circuit, and the reason why a writ of certiorari should be granted, are set forth in the foregoing petition.

4. The ground upon which the writs are asked for is based upon Rule 38, 5 (b) of the Rules of your Honorable Court for the reason that the lower court has rendered a decision involving a Federal question in conflict with the decisions of the Circuit Court of Appeals for the Third Circuit in the cases of *Metropolitan Edison Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 807 and *Pennsylvania Water and Power Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 812.

STATEMENT OF THE CASE AND QUESTIONS INVOLVED.

The petition for the writs of certiorari contains a statement of the question involved in this case, as well as of all the facts material to its consideration. In the interest of brevity the same have not been repeated here.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred—

1. In holding that the absorption of the North Penn Power Company and the Susquehanna County Light and Power Company by the Northern Pennsylvania Power Company pursuant to the provisions of Section 23 of the Pennsylvania General Corporation Act of 1874 as amended, did not have the incidents of a strict merger under Pennsylvania law.

2. In holding that the Northern Pennsylvania Power Company in determining its net taxable income was not entitled to deduct the unamortized debt discount and expense in connection with the bonds of the North Penn Power Company and Susquehanna County Light and Power Company which were redeemed and retired in the taxable years 1926 and 1927.

3. In entering judgment for the respondent.

SUMMARY OF ARGUMENT.

The argument is summarized in the proposition set forth under the caption "Argument."

ARGUMENT.

The Merger of Two Pennsylvania Corporations Under the Pennsylvania General Corporation Act of 1874, as Amended, is Such a Merger as Entitles the Successor Corporation Upon the Redemption and Retirement of the Bonds of the Predecessor Corporation to Take as a Deduction in Computing its Taxable Income Under the Revenue Act of 1926 the Unamortized Debt Discount and Expense Which Had Been Incurred at the Time of the Issuance of the Bonds.

The lower court in its opinion very ably summarized the issue in controversy in this proceeding in the following language, page 563 of the reports:

"It is conceded that unamortized discount and expenses incurred in connection with the issue and sale of bonds are deductions available to the issuing corporation when it pays them off prior to maturity. See Helvering *v.* Union Pacific R. Co., 293 U. S. 282, 55 S. Ct. 165, 79 L. Ed. 363; Great Western Power Co. *v.* Commissioner, 297 U. S. 543, 56 S. Ct. 576, 80 L. Ed. 853. It is also not disputed that such items are allowable deductions to a successor corporation which through merger or consolidation has carried forward the corporate identity of the issuing corporation and has succeeded by operation of law to its rights and liabilities. American Gas & Elec. Co. *v.* Commissioner, 2 Cir., 85 F. 2d 527; New York Central R. Co. *v.* Commissioner, 2 Cir., 79 F. 2d 247, certiorari denied 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465; Western Maryland Ry. Co. *v.* Commissioner, 4 Cir., 33 F. 2d 695. When, however, the successor corporation acquires the assets of the issuing corporation by purchase, rather than by a consolidation or merger, such deductions are not available. American Gas & Elec. Co. *v.* Commissioner, 2 Cir., 35 F. 2d 527; American Gas & Elec. Co. *v.* United States, 17 F. Supp. 151, Ct. Cl.; Turner-Farber-Love Co. *v.* Helvering, 62 App. D. C. 369, 68 F. 2d 416. Whether the transactions at bar are to be classed as mergers or as purchases is the issue in controversy.

"The solution of the problem must be sought in the law of Pennsylvania."

The lower court then proceeded to determine what it believed to be the law of Pennsylvania as to the

effect of a transaction by which the assets and franchises of one corporation are taken over by another pursuant to the provisions of Section 23 of the Pennsylvania General Corporation Act of April 1874, as amended. The court held that such a transaction did not constitute a technical merger since in its opinion the successor corporation under the Act of 1874, as amended, does not become responsible for the liabilities of the merged corporation by operation of law. The court thereby concluded that the Northern Pennsylvania Power Company did not become responsible by operation of law for the liabilities of the North Penn Power Company and the Susquehanna County Light and Power Company, and consequently, under the decision in *American Gas & Electric Company* v. *Commissioner* (C. C. A. 2), 85 Fed. (2d) 527, the deduction of unamortized debt discount and expense should be disallowed.

The Circuit Court of Appeals for the Third Circuit in the case of *Metropolitan Edison Company, Petitioner,* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 807, and in the case of *Pennsylvania Water and Power Company, Petitioner,* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 812, had before it for disposition the exact question presented to the Circuit Court of Appeals for the Second Circuit in this proceeding. The taxpayers in those cases had been involved in transactions under the Pennsylvania General Corporation

Act of 1874, as amended (appendix *infra*), and had deducted for the purpose of computing their income tax liability in the years in which they redeemed bonds of predecessor corporations the unamortized debt discount and expense incurred at the time of the issuance of the bonds.

The Circuit Court of Appeals for the Third Circuit found that under the law of Pennsylvania a successor corporation becomes responsible by operation of law for the liabilities of a predecessor corporation with which it is merged under the Pennsylvania General Corporation Act of 1874, as amended (appendix *infra*), and, as a consequence, the petitioners in the cases before it were entitled to the deductions claimed under the ruling in the *American Gas & Electric Company* v. *Commissioner*, 85 Fed. (2d) 527 (C. C. A. 2); *New York Cent. R. Co.* v. *Commissioner*, 79 Fed. (2d) 247 (C. C. A. 2); cert. den. 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner*, 33 Fed. (2d) 695 (C. C. A. 4); *American Gas & Elec. Co.* v. *U. S.*, 17 Fed. Supp. 151 (Ct. Cls.).

Petitioner here contends that the law of Pennsylvania with respect to mergers under the Act of 1874, as amended (appendix *infra*), is as determined by the Circuit Court of Appeals for the Third Circuit for the reason set forth in the opinion of that court in the case of *Metropolitan Edison Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent* (C. C. A. 3rd, 1938), 98 Fed. (2d) 807, which for the sake of brevity will not be repeated here.

Since the Circuit Court of Appeals for the Second Circuit came to a contrary determination as to the law of Pennsylvania with respect to mergers under the Act of 1874, as amended (appendix *infra*), there is a direct conflict in the decisions in the two circuits in cases raising identical issues with respect to the Federal Income Tax law. There is, therefore, a basis for the invocation of Rule 38 of this Court.

It is respectfully called to the attention of your Honorable Court that the Commissioner of Internal Revenue, through his counsel, filed with your Honorable Court on November 23, 1938, petitions for writs of certiorari to review the decisions of the Circuit Court of Appeals for the Third Circuit in the cases of *Metropolitan Edison Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent, supra,* and *Pennsylvania Water and Power Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent, supra.*

CONCLUSION.

It is therefore respectfully submitted that the petition for writs of certiorari should be granted as prayed for.

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Counsel for Petitioner.

WILLIAM H. S. WELLS
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DECEMBER 1, 1938.

APPENDIX.

STATUTES INVOLVED.

Section 23 of the Pennsylvania General Corporation Act of 1874, as amended.

(Purdon's Penna. Statutes, Annotated (Permanent Ed.), Title 15, Section 595.)

"SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property.*—Any corporation created under the provisions of this act, and any corporation of the classes named in the second section thereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first, and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: *Provided,* That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and prop-

erty, shall have filed with the Secretary of the Commonwealth, a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition, and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date. * * * (1874, April 29, P. L. 73, Sec. 23; 1876, April 17, P. L. 30, Sec. 5; 1915, June 2, P. L. 724, Sec. 1; 1931, June 12, P. L. 561, Sec. 1)."

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